

General Information Letter: Alternative apportionment petition could not be granted because it was not timely filed for old taxable years and, for current year, contained no information that would support a conclusion that the statutory apportionment formula did not fairly represent the business activities of the taxpayer in Illinois or that the alternative would better represent the business activities of the taxpayer in Illinois.

June 29, 2006

Dear:

This is in response to the letter from Mr. Z, dated June 8, 2006, in which he requested permission pursuant to Section 304(f) of the Illinois Income Tax Act (the "IITA"; 35 ILCS 101 *et seq.*) for COMPANY1 to use the average of the apportionment factors computed under Section 304(b) of the IITA for calendar years 1995 through 1999 to apportion its income for 2000 and subsequent years, rather than to use the statutory apportionment factor for each year. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 86 Ill. Adm. Code 1200.120(b) and (c), which may be found on the Department's web site at www.revenue.state.il.us. For the reasons discussed below, your petition cannot be granted at this time.

In Mr. Z's letter, he states the following:

This serves as a petition for an alternative apportionment method for COMPANY1, in Liquidation ("COMPANY1"), an Illinois corporation. IITA Section 304(f) provides that if the allocation and apportionment provisions of IITA Sections 304(a) through (e) and (h) do not fairly represent the extent of a person's business activity in Illinois, the person may petition for an alternative apportionment formula. The alternative method proposes the use of a 5-year historical average of premiums written in Illinois to total premiums written. This average is 1.4319% and is based on IL-1120 tax returns filed for tax years 1995 through 1999. This apportionment rate would be used to calculate income allocable to Illinois for the tax years 2000 and later.

Additional details and a history of the relevant transactions are discussed below that justify an alternate apportionment formula for tax years 2000 and later, based on the unusual facts and circumstances of this company.

The Circuit Court of Cook County, Illinois, entered an Agreed Order of Liquidation With a Finding of Insolvency and Injunctive Relief against COMPANY1 on June 28, 2000. The Illinois Director of Insurance is the statutory and court affirmed Liquidator. The COMPANY2 (COMPANY2), an Illinois not-for-profit corporation, is handling the liquidation proceedings on behalf of the Liquidator. A certified court order and the Liquidator's Power of Attorney are enclosed for your reference. Prior to the end of 2000, all of COMPANY1's records were transferred to the COMPANY2 and the employment of all COMPANY1 employees was terminated. Pursuant to Section 194 of the Illinois Insurance Code, 215 ILCS 5/194, and the liquidation order, the liabilities of COMPANY1 were fixed as of the June 28, 2000 liquidation date with limited exceptions. In addition, there were not any COMPANY1 policies and/or certificates of insurance

issued after 1997 and all premiums were fully earned by 1998.

COMPANY1 is taxed as a property and casualty insurance company under Internal Revenue Code (IRC) Section 831. The receivership has no impact from an income tax standpoint, and accordingly, COMPANY1 prepares federal Form 1120-PC as required by Rev. Rul. 84-170, 1984-2 C.B. 245. This return is included in the federal consolidated tax return filing of its parent corporation, COMPANY3 (COMPANY3). Prior to the 2000 receivership, COMPANY1 historically wrote business in many states with very little in Illinois. As a property and casualty insurance company, COMPANY1's base income or loss allocable to Illinois was derived from its premiums written throughout the United States. Attached is an analysis of COMPANY1's premiums written from 1995 through 1999, which illustrates how little business was written in Illinois in those years (see Exhibit 1). As a result, its Illinois apportionment factor was very small.

Exhibit 2 further illustrates why using a historical apportionment factor would more fairly represent COMPANY1's activity in Illinois. The unitary group's Illinois base income for 1995 through 1999 exceeds \$26.7 million in losses. However, only a net \$215,081 business loss is allocable to Illinois – less than 1%. As noted earlier, COMPANY1's liabilities were fixed as of the 2000 liquidation date and nearly all of its liabilities were insurance related. As of this date, there have not been any claims paid since the liquidation order was entered, as the Liquidator finalizes the evaluation of all timely filed proofs of claim. Thus, substantially all of COMPANY1's liabilities continue to be ones incurred well before 2000. The COMPANY2 is anticipating that COMPANY1's ultimate claims liability will be far less than the \$17.7 currently being carried on their books, amounts originally determined by COMPANY1 personnel in 2000. It would be extremely inequitable to COMPANY1 if they were required to recognize 100% of this as Illinois income (due to a decrease in insurance liabilities) when only 1 to 2% of the original federal losses incurred deduction was allocated to Illinois. COMPANY1 has not yet filed IL-1120's for 2000 through 2004, covering the first five years of receivership and does not intend to file these returns until the apportionment factor issue is addressed. The COMPANY2 believes the same apportionment factor should be used beginning in 2000 when COMPANY1 was placed in receivership. Exhibit 3 summarizes COMPANY1's taxable income for the years 2000 through 2004 as reported on its Form 1120-PC proforma which were included in the COMPANY3 federal consolidated income tax returns. The 2004 return has not yet been finalized, but preliminary calculations show a loss between \$800,000 to \$900,000.

Another relevant matter to raise is the unitary group situation. COMPANY1 was part of a unitary group with its parent, COMPANY4, Inc., formerly known as COMPANY5, Inc. COMPANY6, Ltd., an alien insurance company organized under the laws of the Cayman Islands, British West Indies, joined the Illinois unitary group in 1999. COMPANY2 takes the position that beginning with the 2000 tax year, COMPANY1 should file on its own since COMPANY4 and COMPANY6 are under the control of the parent company, COMPANY3, and the Liquidator is responsible solely for COMPANY1. COMPANY3 involvement and authority over COMPANY1 ceased one the liquidation

order was entered. The business activities of COMPANY1, COMPANY4 and COMPANY6 are no longer integrated with, dependent upon and contribute to each other." (35 ILCS 5/1501(a)(27).

In light of the foregoing, we respectfully request that the Illinois Department of Revenue approve the alternative apportionment plan described in this petition.

Response

Section 304(f) of the IITA provides:

If the allocation and apportionment provisions of subsections (a) through (e) and of subsection (h) do not fairly represent the extent of a person's business activity in this State, the person may petition for, or the Director may require, in respect of all or any part of the person's business activity, if reasonable:

- (1) Separate accounting;
- (2) The exclusion of any one or more factors;
- (3) The inclusion of one or more additional factors which will fairly represent the person's business activities in this State; or
- (4) The employment of any other method to effectuate an equitable allocation and apportionment of the person's business income.

Taxpayers who wish to use an alternative method of apportionment under this provision are required to file a petition complying with the requirements of 86 Ill. Adm. Code Section 100.3390, which may be found on the Department's web site at www.tax.illinois.gov.

Please note that 86 Ill. Adm. Code Section 100.3390(e)(1) requires a petition to be filed at least 120 days prior to the due date (including extensions) for the first return for which permission is sought to use the alternative apportionment method. A petition filed June 8, 2006 will allow a taxpayer to use the requested method on original returns due on or after October 6, 2006, if granted. Because calendar-year taxpayers are automatically granted an extension of time to file returns until October 15 of the year following the taxable year under 86 Ill. Adm. Code Section 100.5020(b), this petition is timely for calendar year 2005. However, the petition is not timely for calendar years 2000 through 2004. Accordingly, in order to obtain permission to use an alternative apportionment formula for those years, COMPANY1 must file its Illinois income tax returns for those years using the statutorily-prescribed apportionment formula and then file an amended return for each year using the desired alternative apportionment formula, with a petition to use that formula attached. See 86 Ill. Adm. Code Section 100.3390(e)(2).

With respect to the petition as it applies to 2005, 86 Ill. Adm. Code Section 100.3390(c) provides:

A departure from the required apportionment method is allowed only where such methods do not accurately and fairly reflect business activity in Illinois. An alternative apportionment method may not be invoked, either by the Director or by a taxpayer, merely because it reaches a different apportionment percentage than the required statutory formula. However, if the application of the statutory formula will lead to a grossly distorted result in a particular case, a fair and accurate alternative method is appropriate. The party (the Director or the taxpayer) seeking to utilize an alternative apportionment method has the burden of going forward with the evidence and proving by clear and cogent evidence that the statutory formula results in the taxation of extraterritorial values and operates unreasonably and arbitrarily in attributing to Illinois a percentage of income which is out of all proportion to the business transacted in this State. In addition, the party seeking to use an alternative apportionment formula must go forward with the evidence and prove that the proposed alternative apportionment method fairly and accurately apportions income to Illinois based upon business activity in this State.

The petition contains no description of the activities of COMPANY1 within and without this State during 2005 and gives no explanation as to why the premiums factor for the period from 1995 through 1999 fairly and accurately reflects the 2005 activities. Accordingly, the petition cannot be granted at this time for the 2005 return, either.

With respect to the issue of whether or not COMPANY1 should be included in a unitary business group with any other taxpayers, we cannot issue a binding opinion without more details concerning the relationship of COMPANY1 to the other taxpayers. Any request for a binding private letter ruling would need to be filed in accordance with the procedures described in 86 Ill. Adm. Code Section 1200.110.

As stated above, this is a general information letter which does not constitute a statement of policy that applies, interprets or prescribes the tax laws, and it is not binding on the Department. If you still believe that your petition should be granted, please supplement the petition in accordance with the provisions of 86 Ill. Adm. Code Section 100.3390. If you have any questions, you may contact me at (217) 524-3951.

Sincerely,

Paul S. Caselton
Deputy General Counsel -- Income Tax